

Supplemental Letter of Findings Number: 04-20110020
Sales Tax
For the Years 2007-2009

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ISSUE

I. Sales Tax—Construction Contractors.

Authority: IC § 6-8.1-5-1; [45 IAC 2.2-3-9](#); [45 IAC 2.2-3-10](#); [45 IAC 2.2-3-11](#); [45 IAC 2.2-3-12](#); [45 IAC 2.2-4-22](#); [45 IAC 2.2-4-23](#); [45 IAC 2.2-4-24](#); [45 IAC 2.2-4-26](#).

Taxpayer protests the Department's assessment of sales tax on its construction contracts.

STATEMENT OF FACTS

Taxpayer is a corporation doing business in Indiana. Taxpayer sells merchandise at its stores. In addition, Taxpayer enters into contracts with some of its customers for real property improvements.

Whenever customers wish to have a real property improvement performed to their residence or other customer-owned real property, the customers enter into a contract for the improvement with Taxpayer. Taxpayer supplies the materials necessary and subcontracts the labor to third-party agents to perform the actual installation. Title to the goods does not transfer to the customers until such goods are affixed to the property.

According to Taxpayer, Taxpayer's customers pay the entire contract price when the contract is executed. Taxpayer's customers do not pay any additional amounts to Taxpayer based upon the amount of time or material necessary to perform the real property improvement. The initial itemization of the lump-sum amount into labor and materials components solely represents an estimate of anticipated labor and materials costs. The actual contract price does not change based on the actual labor or materials ultimately used to fulfill the contract obligations.

Taxpayer treated these contracts as lump-sum contracts for sales and use tax purposes. Thus, Taxpayer self-assessed use tax on the tangible personal property specified in the contract and did not charge its customers sales tax on the tangible personal property. The use tax was remitted based on Taxpayer's own purchase price of the tangible personal property.

The Indiana Department of Revenue ("Department") disagreed with Taxpayer's characterization of its construction contracts as "lump sum" contracts. Instead, the Department characterized the contracts as "time and materials" contracts.

Because the Department characterized the contracts as "time and materials" contracts, Taxpayer was categorized as a retail merchant with regard to the tangible personal property portion of the contracts and, according to the Department, should have assessed sales tax on the retail value of the materials sold to the customers. The Department assessed sales tax based on Taxpayer's contracts, while permitting an offset for the use tax previously remitted by Taxpayer.

Taxpayer protested this portion of the assessment. However, Taxpayer acknowledged at the original hearing that, to the extent the tangible personal property was not incorporated in real property (e.g., appliances), these sales of tangible personal property were subject to sales tax.

The Department previously conducted an administrative hearing addressing Taxpayer's protest. The Department issued a Letter of Findings partially sustaining and partially denying Taxpayer's protest. Taxpayer requested a rehearing on the issue of its installation contracts. The Department granted the rehearing, conducted the rehearing, and this Supplemental Letter of Findings results.

I. Sales Tax—Construction Contractors.

DISCUSSION

Taxpayer protests the assessment of additional sales tax on various items used in the fulfillment of construction contracts. The issue is whether Taxpayer's contracts are "lump-sum" contracts or "time and materials" contracts.

IC § 6-8.1-5-1(c) states in relevant part:

The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

A "lump-sum" contract is a contract for which all necessary materials and labor are performed for one specified price. In a lump-sum contract, the customer is not charged sales tax; however, the construction contractor generally must pay sales tax or self-assess use tax on its purchase price for the materials. [45 IAC 2.2-3-9\(e\)\(3\)](#); [45 IAC 2.2-3-10\(3\)](#); [45 IAC 2.2-4-22\(e\)\(3\)](#); [45 IAC 2.2-4-23\(3\)](#). Thus, if contractor B enters into a lump-sum contract with customer C for \$10,000, B is not a retail merchant on this transaction and does not collect sales tax. However, if B pays A \$4,000 for materials incorporated in C's real property, B must pay sales tax or

self-assess use tax on the \$4,000 unless C could have purchased the materials directly without incurring sales and use tax.

A "time and materials" contract is a contract in which the materials and labor are sold for separately quoted prices. Using the transaction described above, if B and C entered in a contract for a \$10,000 total price, with \$4,500 for materials and \$5,500 for labor, B is treated as a retail merchant selling the materials to C and must collect sales tax on the \$4,500 in materials. However, when B purchases the materials for \$4,000 from merchant A, B can purchase the materials exempt because B is treated as a reseller. [45 IAC 2.2-3-9\(d\)\(1\)](#); [45 IAC 2.2-4-22\(d\)\(1\)](#). However, the fact that an invoice provides a separate listing for materials and labor does not necessarily result in a contract being a time and materials contract. [45 IAC 2.2-3-12\(e\)](#).

Indiana tax regulations discuss retail merchants who also serve as contractors. Under [45 IAC 2.2-3-11\(c\)](#) and [45 IAC 2.2-4-24\(c\)](#), a contractor may serve both as a retail merchant and an installer. Under these regulations, the contractor first serves as a retail merchant for the materials incorporated into real property. Thereafter, the customer is treated as if the customer has provided the materials to the contractor for the contractor's installation.

In the most basic terms, Taxpayer's position is that a lump-sum contract is a contract in which the price of the entire transaction is fixed at the time the contract is initially executed. Further, Taxpayer's position is that the contract is a lump-sum contract if the contractor (as opposed to the customer) absorbs the liability for any material and/or labor costs in excess of the originally-quoted price.

By contrast, the Department's audit cited to [45 IAC 2.2-4-26](#), and noted that Taxpayer listed materials and labor separately in the contracts. The Department, noting the separate listing of materials and labor, determined that the contracts were in fact "time and materials" contracts. Taxpayer states that its customers do not pay any additional amount to Taxpayer based upon the amount of time or material necessary to perform the real property improvement.

Taxpayer provided copies of several invoices. Page one of the invoices has a heading referred to as "Merchandise and Installation Summary." Immediately below the "Merchandise and Installation Summary" is a "Merchandise Summary," listing various merchandise items. The "Merchandise Summary" lists quantities of merchandise to be used in fulfillment of the contract and a total merchandise price. The price listed conforms to the retail price of the property listed in the "Merchandise Summary."

Below the "Merchandise Summary" is an "Installation Description." The "Installation Description" lists various specifications for the installation of the property and includes certain "Additional Specifications" depending on the particular property requested by the customer and installation.

For illustration purposes only, a sample Taxpayer invoice would state:

MERCHANDISE SUMMARY

01234:QWERTY123:SOS AREA(AB-123):ADHESIVE 1 GALLON:AB-123- QTY 1
 01234:QWERTYZXC:SOS AREA(AB-123): MOLDING:AB-123- QTY 1
 98765:ASDFGHLKJ:SOS LEVEL:WOOD CABINET:BIG BOB-QTY 3

Materials Price \$5,000

INSTALLATION DESCRIPTION

<Various Technical Specifications>

Labor Charges \$2,000
 Detail Deduction \$ 50

Additional Specifications:

<Notes and certain limitations, such as what Taxpayer will not do or other requirements>

TOTAL CHARGES OF ALL MERCHANDISE AND SERVICES

Sub-Total	\$6,950
Sales Tax	\$ 0
Delivery	\$ 75
Order Total	\$7,025
Balance Due	\$ 0

<Boilerplate notices, work start/end, and customer signature>

Taxpayer states that, notwithstanding the separate listings, the \$7,025 price is actually a single, negotiated price for all items necessary for the installation of the property. In support of this contention, Taxpayer notes the section of the contract labeled "Notice to Customer" and highlights the first sentence which reads, "All items listed in this contract and specification sheet(s) are to be installed under conditions agreed upon at time of purchase and at the price appearing on this contract form." Further, at the end of the contract, under "Terms and Conditions," Taxpayer directs the Department to language stating "The Price owed by Customer to [Taxpayer] covers the Goods, Installation Services, and applicable taxes."

Taxpayer asserts that its construction contracts are for one price, established at the time of service, rather

than separate charges for labor and materials. Further, Taxpayer states that, absent extraordinary circumstances (e.g., a flooring contract where the underlying floor is in substandard condition), the price remains the same even if more materials than originally projected are used or the project requires more labor than anticipated.

Finally, Taxpayer argues that, if an issue arises with the installation (e.g., substandard work or an installation results in unanticipated damages), Taxpayer assumes the burden of any additional materials and labor necessary to correct any problems. In support of its contention, Taxpayer provided a copy of an invoice related to a customer who had several issues with the installation of flooring. Taxpayer stated that it reinstalled the property at no additional charge to the customer. Taxpayer further provided a list of instances in which it requested insurance payments for materials resulting from various installation issues. Taxpayer also provided a copy of its "installed sales" procedures in place at its retail locations.

Taxpayer's argument—that a lump-sum contract is one where the price is fixed prior to the execution of the contract—has some superficial appeal. However, for many of Taxpayer's installation services, Taxpayer has provided specific computations inconsistent with a true lump-sum contract. For instance, paragraph 11 of the "installed sales" procedures provides that "employees do not receive an employee discount on installed sales labor; however, employees may purchase installed special order and stock merchandise at employee price." However, the clause does permit discounts on the combined price of materials and labor when products are sold only with installation. Furthermore, paragraph 12 of the "installed sales" procedures provides for procedures to allow "the customer to purchase a water heater for installation" without separate charges for installation. Finally, on Taxpayer's website, Taxpayer specifically lists offers providing for discounted or free installation.

Taxpayer has provided information on its stated policies related to construction installation contracts. Taxpayer has provided information on other aspects of its operations related to installation contracts. However, based on the totality of the information provided, Taxpayer's actual operations require the conclusion that labor and materials are separate components of its contracts, as opposed to one combined component. As such, Taxpayer has not rebutted the presumption under IC § 6-8.1-5-1 that the proposed assessment is correct as it relates to its materials installation contracts.

FINDING

Taxpayer's protest is respectfully denied.

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